No. 05-996

Supreme Court, U.S.
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In The Supreme Court of the United States

ROBERT LOUIS MARRAMA,

Petitioner,

v.

CITIZENS BANK OF MASSACHUSETTS AND MARK G. DEGIACOMO, CHAPTER 7 TRUSTEE,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

BRIEF OF THE NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT, MARK G. DEGIACOMO, CHAPTER 7 TRUSTEE

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STATEMENT OF INTEREST OF THE NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES AS *AMICUS CURIAE*

The National Association of Bankruptcy Trustees ("NABT") is a non-profit association formed in 1982 to address the needs of chapter 7 bankruptcy trustees throughout the country, and to promote the effectiveness of the bankruptcy system as a whole.[1] There are currently 1,200 bankruptcy trustees receiving new cases, and approximately 1,000 of these chapter 7 panel trustees are NABT members.

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[1] Undersigned counsel for NABT authored this brief in its entirety, and no other person or entity, other than NABT, has made any monetary contribution to the preparation or submission of this brief. Consent of all parties to the submission of *amicus curiae* briefs has been lodged with the Clerk of the Court.

This appeal addresses the issue of whether a chapter 7 debtor has an absolute right to convert to a chapter 13 case, despite factual findings that establish bad faith and indicate that conversion would result in an abuse of the bankruptcy process. NABT supports the Respondent, Chapter 7 Trustee's position that a chapter 7 debtor does not have an absolute right to convert to chapter 13. NABT's support is important because this Court's decision will affect the ability of trustees throughout the country to effectively administer chapter 7 cases in accordance with their fiduciary mandates under the Bankruptcy Code.

Trustees are duty bound to assist in detecting and prosecuting fraudulent or abusive conduct by debtors. An absolute right to convert from chapter 7 to chapter 13 enables dishonest debtors to obstruct trustees from performing their statutory duties. Accordingly, NABT urges this Court to affirm the decision of the First Circuit Court of Appeals, holding that conversion from chapter 7 to chapter 13 should be denied in circumstances of bad faith and abuse of the bankruptcy system.

SUMMARY OF ARGUMENT

Chapter 7 trustees, as the fiduciaries responsible for the administration of all chapter 7 bankruptcy cases, are charged with preserving and promoting the system's integrity by, among other things, helping to detect fraudulent or abusive conduct. Allowing courts to refuse conversion in circumstances of bad faith ensures that the integrity of the bankruptcy system is not compromised.

Furthermore, the legislative policy of encouraging honest debtors to repay debts in chapter 13 is not constrained by the exercise of judicial discretion to deny conversion in situations where a debtor seeks to deploy § 706(a) of the Bankruptcy Code manipulatively and abusively. Indeed, to allow dishonest debtors to convert to chapter 13 on the heels of their own fraud and abuse, emasculates the Code's enforcement provisions and defeats the core bankruptcy principle that the Bankruptcy Code must not be used to further fraudulent purposes.

ARGUMENT

I. BANKRUPTCY COURTS, BANKRUPTCY TRUSTEES, AND CHAPTER 7 DEBTORS ARE ALL DUTY BOUND TO ENSURE THE INTEGRITY OF THE BANKRUPTCY SYSTEM.

The First Circuit recognizes a debtor's general good faith filing requirement as rooted in the basic bankruptcy principle that bankruptcy courts must not be used to further fraudulent purposes. *In re Coastal Cable T.V., Inc.*, 709 F.2d 762, 764-65 (1st Cir. 1983); *see also In re Integrated Telecom Express, Inc.*, 384 F.3d. 108, 119 (3d Cir. 2004) ("...good faith requirement ensures that the Bankruptcy Code... is not undermined by petitioners whose aims are antithetical to the basic purposes of bankruptcy.")

In *Coastal Cable*, the First Circuit said: "A bankruptcy court, 'in the exercise of its equitable jurisdiction... has the power to sift the circumstances of

any claim to see that injustice or unfairness is not done in the administration of the bankruptcy estate.'" *In re Coastal Cable* at 764 (*citing Pepper v. Litton*, 308 U.S. 295, 304-05 (1939)). In this case, the First Circuit elaborated further on this fundamental canon of the Bankruptcy Code, stating that:

> a bankruptcy court sitting in equity is duty bound to take all reasonable steps to prevent a debtor from abusing or manipulating the bankruptcy process to undermine the essential purposes of the Bankruptcy Code, including the principle that all the debtor's assets are to be gathered and deployed in a bona fide effort to satisfy valid claims.

Marrama v. Citizens Bank of Mass. and DeGiacomo (In re Marrama), 430 F.3d 474, 477 (1st Cir. 2005), *cert. granted*, __ U.S. __, 126 S. Ct. 2859 (2006) ("*Marrama*").

Under the Bankruptcy Code, chapter 7 trustees are charged with statutory and general duties intended to preserve the integrity of the bankruptcy system and to promote the effective and efficient administration of bankruptcy cases. Among other things, the chapter 7 trustee is charged with investigating the financial affairs of the debtor, collecting and reducing to money the property of the estate and closing the estate as expeditiously as is compatible with the best interests of parties in interest. 11 U.S.C. §§ 704(a)(1), (4).

Chapter 7 debtors are also charged with various duties under § 521 of the Bankruptcy Code, likewise

designed to ensure the system's integrity and efficiency. These include the duty to file schedules of assets and liabilities, schedules of income and expenses, and a statement of financial affairs. 11 U.S.C. § 521(a)(1). Rule 1008 of the Federal Rules of Bankruptcy Procedure requires that debtors file these schedules and statements under the pains and penalties of perjury. Fed. R. Bankr. P. 1008.

A debtor's statutory mandate to file complete and truthful schedules and statements ensures the proper administration of a bankruptcy case, and compliance is essential to maintaining the underlying integrity of the bankruptcy process. *See Boroff v. Tully (In re Tully)*, 818 F.2d 106, 110 (1st Cir. 1987); *In re Rolland*, 317 B.R. 402, 746 (Bankr. C.D. Cal. 2004); *Schecter v. Hansen (In re Hansen)*, 325 B.R. 746 (Bankr. N.D. Ill. 2005). Furthermore, debtors are specifically required by § 521(a)(3) of the Bankruptcy Code to cooperate with chapter 7 trustees in the administration of the bankruptcy estate.

Inasmuch as trustees often administer over one thousand cases each year, they rely on debtors to perform their § 521 duties without the need to dig for the truth and conduct independent investigations to get to the facts. *See Mertz v. Rott*, 955 F.2d 596, 598 (8th Cir. 1992). As the Seventh Circuit articulated over twenty years ago: "If debtors could omit assets at will, with the only penalty that they had to file an amended claim [or convert] once caught, cheating would be altogether too attractive." *Payne v. Wood*, 775 F.2d 202, 206 (7th Cir. 1985), *cert. denied*, 475 U.S. 1085 (1986).

Another keystone of the bankruptcy system is the "fresh start" policy, which affords chapter 7 debtors who provide full and accurate information and cooperate with the trustee in the bankruptcy process a full or partial discharge of their debts. *See In re Hansen*, 325 B.R. at 757. Debtors are granted this fresh start in exchange for their "honest and forthright invocation" of the Bankruptcy Code's protections. *Kestell v. Kestell (In re Kestell)*, 99 F.3d 146, 149 (4th Cir. 1994). Hence, as a condition precedent to invoking the privileges and protections afforded by bankruptcy, debtors must abide by their statutory duties under § 521 of the Bankruptcy Code.

Judicial pronouncements on the importance of debtors' utmost compliance with their statutory duties are plentiful. *Id.; see, e.g., In re Colvin*, 288 B.R. 477, 479-81 (Bankr. E.D. Mich. 2003) (citations omitted); *In re Rolland*, 317 B.R. 402, 413-414 (Bankr. C.D. Cal. 2004) (citations omitted); *In re Robinson*, 292 B.R. 599, 607-08 (Bankr. S.D. Ohio 2003) (citations omitted); *Job v. Calder (In re Calder)*, 93 B.R. 734, 738 (Bankr. D. Utah 1988), *aff'd*, 907 F.2d 953 (10th Cir. 1990) *citing Chalik v. Moorland (In re Chalik)*, 748 F.2d 616, 618 (11th Cir. 1984). As such, good faith reporting is essential to the administration of chapter 7 cases, and vital to maintaining the system's integrity. *In re Rolland*, 317 B.R. 402 (Bankr. C.D. Cal. 2004); *see Cusano v. Klein*, 264 F.3d 936, 946 (9th Cir. 2001); *In re Kestell*, 99 F.3d at 149.

The duties of chapter 7 trustees are numerous, and unique to their primary role of protecting the interests of creditors, while at the same time shepherding honest debtors through the bankruptcy

process toward the fresh start that many desperately need. The position advanced by the National Association of Consumer Bankruptcy Attorneys ("NACBA"), *Amicus Curiae* for Petitioner, in comparing the duties of chapter 7 trustees with chapter 13 trustees, is unpersuasive. NACBA summarily states that a chapter 13 trustee would have the "same duties of financial investigation and protection of estate value" as a chapter 7 trustee. (Br. of Nat'l Ass'n of Consumer Bankr. Atty's at 5). This view does not comport with the realities of bankruptcy practice.

Section 704(a)(1) of the Bankruptcy Code provides that a chapter 7 trustee must collect and reduce to money property of the estate, and close a case expeditiously. This is not included in § 1302(b) as a chapter 13 trustee's duty, because in chapter 13, it is the debtor, and not the trustee, who controls all property of the bankruptcy estate. This distinction is critical, and supports the position that a bankruptcy court has the power to deny a chapter 7 debtor who has acted in bad faith the opportunity to convert to chapter 13 - as conversion would place this dishonest debtor in full possession and control of the very assets he intentionally misrepresented or sought to conceal.

Chapter 7 trustees bring myriad recovery actions for the benefit of the bankruptcy estate, including preferential transfers pursuant to § 547,[2] fraudulent transfers pursuant to § 548,[3] unauthorized

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[2] 11 U.S.C. § 547.

[3] 11 U.S.C. § 548.

postpetition transfers pursuant to § 550,[4] and various other actions utilizing the trustee's strong arm powers contained in § 544 of the Bankruptcy Code.[5] Chapter 13 trustees, while statutorily allowed to bring such actions, rarely have the incentive, or the means, to do so.[6] Perhaps most importantly, chapter 7 trustees have the duty and authority to bring an action to deny a debtor's discharge pursuant to § 727 for various forms of fraud and bad faith conduct[7] - there is no comparable duty or authority for a chapter 13 trustee.

In the course of executing their duties, chapter 7 trustees are often in the best position to initially identify fraud, which forms the basis for seeking denial of a debtor's discharge pursuant to § 727 of the Bankruptcy Code. *See Handbook for Chapter 7 Trustees*, U.S. Dept. of J., Exec. Off. of U.S. Trustee, March 2001, 8-44, 8-45; 11 U.S.C. § 727. In doing so, chapter 7 trustees establish practices and procedures for identifying fraud - often nondisclosure or undervaluation of assets intentionally concealed or

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[4] 11 U.S.C. § 550.

[5] 11 U.S.C. § 544.

[6] Standing to bring these actions in chapter 13 cases is presently a matter of some controversy in the courts, with many bankruptcy and appellate courts acknowledging the practical necessity of finding that debtors have standing to exercise the avoidance powers of a trustee, based on the realities of bankruptcy practice and the chapter 13 trustee's lack of incentive to bring such actions. *See Ryker v. Current (In re Ryker)*, 301 B.R. 156, 161 (D. N.J. 2003); *see also Getsey v. Eiler (In re Cohen)*, 305 B.R. 886, 894 (BAP 9th Cir. 2004) (noting limited role of chapter 13 trustee).

[7] 11 U.S.C. § 727.

misrepresented by debtors - in furtherance of their primary duty to act in the best interest of creditors of the debtor's bankruptcy estate. *See Handbook for Chapter 7 Trustees*, 8-44, 8-45.

The investigatory stance of chapter 7 trustees, coupled with their recovery, avoidance and strong arm powers enumerated above, are critical compliance and enforcement mechanisms under the Bankruptcy Code. To allow conversion on the heels of an investigation that uncovers hidden assets and prompts a recovery or enforcement action by the trustee, undermines and emasculates the role of the trustee in the Code's compliance regime, and thereby renders the system ineffective.

Petitioner and NACBA unduly emphasize and place unwarranted significance on certain language in the legislative history of § 706(a) of the Bankruptcy Code.[8] Their arguments fail to recognize that a debtor seeking conversion in direct response to a trustee's investigation and recovery or enforcement action does not seek conversion for the stated legislative purpose of repaying creditors. On the contrary, these debtors seek conversion to avoid the ramifications of their unlawful, bad faith conduct which prompted action by the chapter 7 trustee.

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[8] 11 U.S.C. § 706; *see* S.Rep. No. 95-989 at 94 (1978), *reprinted in* 1978 U.S.C.A.A.N. 5787, 5880; *see also* H.R. Rep. No. 95-595, at 380 (1977), *reprinted in* 1978 U.S.C.A.A.N. 5963, 6336 ("The policy of the provision is that the debtor should always be given the opportunity to repay his debts.")

Likewise, it is disingenuous to suggest that funds that would be recovered by a chapter 7 trustee's avoidance of a fraudulent transfer would readily be surrendered by a dishonest debtor for repayment to creditors in a chapter 13 case. And it is unlikely that a debtor fleeing from a trustee's objection to an ill-claimed exemption in an intentionally undervalued asset would voluntarily submit that asset to liquidation and distribution in chapter 13. It is more likely, and indeed often the case, that the debtor would convert to chapter 13 but fail to file a plan or otherwise comply with chapter 13 procedures, and the case would be dismissed. The debtor could then file another chapter 7 petition at a later date, with a new chapter 7 trustee appointed, having let a statute of limitations run, or taken other steps to evade the basis for the original trustee's objection.

In the present case, the First Circuit Court of Appeals conducted its analysis of whether a chapter 7 debtor who engages in bad faith conduct has an absolute right to convert to chapter 13, in context of a bankruptcy court's paramount duty to adhere to the purposes of the Bankruptcy Code and curb abuse and manipulation of its provisions by debtors. *See Marrama*, 430 F.3d at 477 *(citing United States v. Mourad*, 289 F.3d 174, 178 (1st Cir. 2002), *cert. denied*, 537 U.S. 933 (2002). Section 105(a), the Bankruptcy Code's anti-abuse provision, enables a bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). Accordingly, the bankruptcy court is statutorily vested with broad, discretionary power to take action or to make any determination it deems

necessary or appropriate to prevent abuse of the bankruptcy process.

Moreover, a bankruptcy court is duty bound to invoke its equitable powers under § 105 whenever dishonest debtors act abusively and the integrity of the bankruptcy system is thereby threatened. This enforcement mechanism ensures that the bankruptcy court, as the court of first impression, has the means to curb abuse of its court and provide all participants in the bankruptcy system with an honest, stable process. Accordingly, the First Circuit correctly observed that the duty of the bankruptcy court to curb abuse under § 105(a) "looms large" in an analysis of whether the language of § 706(a) affords a bankruptcy court the discretion to deny conversion from chapter 7 to chapter 13 when facing a patently abusive motion to convert. *Marrama*, 430 F.3d at 477.

II. SECTION 706(a) OF THE BANKRUPTCY CODE IS UNAMBIGUOUS AND AFFORDS DEBTORS ONLY A LIMITED RIGHT TO CONVERT A CHAPTER 7 BANKRUPTCY CASE TO A CHAPTER 13 CASE.

A. The Language of § 706(a) of the Bankruptcy Code is Clear on its Face, and Does Not Afford Debtors an Absolute Right to Convert to Chapter 13.

Section 706(a) of the Bankruptcy Code provides that a debtor "may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time, if the case has not been converted under section 1112, 1208 or 1307 of this title. Any waiver of the right

to convert a case under this subsection is unenforceable." 11 U.S.C. § 706(a).

In this case, the First Circuit Court of Appeals affirmed the decisions of the Massachusetts Bankruptcy Court and the Bankruptcy Appellate Panel for the First Circuit, recognizing that a debtor's right to convert under § 706(a) of the Bankruptcy Code is restrained by the bankruptcy court's discretion to deny conversion in circumstances of bad faith conduct by the debtor. *See Marrama*, 430 F.3d at 481. The First Circuit commenced its analysis of the terms of § 706(a) by stressing the utmost importance of preserving the core principle of maintaining the system's integrity, and the bankruptcy court's power and duty under § 105(a) to advance that principle. The Court continued its analysis, mindful of this paramount preservation mandate.

It is well-settled that if the plain language of a statute resolves an interpretive issue, its manifest meaning must control. *See In re BankVest Capital Corp.*, 360 F.3d 291, 297 (1st Cir.), *cert. denied*, 542 U.S. 919 (2004). Utilizing plain language analysis, the First Circuit found that the plain meaning of this subsection resolved the issue before it:

> Turning to the particular language utilized in subsection 706(a), we can discern no evidence that Congress intended to override the presumptive power and responsibility of the bankruptcy court to weed out abuses of

> the bankruptcy process at any stage in the bankruptcy proceedings.

Marrama, 430 F.3d at 478.

Courts interpret the meaning of a statute by first assuming that the words used in the statute comport with ordinary meaning and accurately express legislative intent. *See Laaman v. Warden, New Hampshire State Prison*, 238 F.3d 14, 16 (1st Cir. 2001). The language of § 706(a) indicates judicial discretion, and contains two distinct protections against judicial or other encroachment upon the debtor's qualified right to convert. Neither of these stated protections describes the right to convert as absolute.

Section 706(a) provides that the debtor "may" convert his case at "any time." The First Circuit found the use of the word "may," which signifies conditionality, instead of the more imperative term "shall," to be a compelling distinction. The Court noted that the use of the word "shall" in other sections of the Bankruptcy Code, such as § 1307(b),[9] demonstrates that the drafters knew how to use statutory language that confers little to no discretion on the bankruptcy court, and chose not to use such compulsory language in § 706(a). Accordingly, the Court held that the word "may" indicates the existence of a privilege, rather than an absolute right, reserving discretion in the bankruptcy court to deny conversion in certain circumstances. *See Marrama*, 430 F.3d at 477-78 (*citing Citizens Awareness Network, Inc. v. United States*, 391 F.3d 338, 346 (1st Cir. 2004)) ("Congress' use

[9] 11 U.S.C. § 1307(b).

of differential language in various sections of the same statute is presumed to be intentional and deserves interpretive weight.").

NACBA suggests that the word "may" connotes discretion, and argues that use of the word in § 706(a) means that Congress has granted the debtor a permissive right to convert his chapter 7 case at his own discretion. (Br. of Nat'l Ass'n of Consumer Bankr. Atty's at 8). As the First Circuit aptly points out, however, "may" often suggests conditionality, signifying that a debtor might normally succeed in an attempted conversion, but not necessarily in all circumstances. Under this reading, "may" still connotes discretion, but the discretion is held by the court and not the debtor. This reading of the word "may" is bolstered by a comparison to other sections of the Bankruptcy Code that use the word "shall" to expressly eliminate the bankruptcy court's discretion. *See Marrama*, 430 F.3d at 478, *see also In re Marcakis*, 254 B.R. 77, 82 (Bankr. E.D. N.Y. 2000) ("simply put, 'shall' means 'must,' something mandatory, and 'may' connotes the permissive, the possible").

The First Circuit similarly found that the phrase "at any time" merely suggests that conversion is not subject to temporal restrictions. The phrase, by its ordinary meaning, does not grant debtors broad permission to convert because "at any time" simply does not mean "regardless of the circumstances." *See Marrama*, 430 F.3d at 479; *see also Copper v. Copper (In re Copper)*, 426 F.3d 810 (6th Cir. 2005); *In re Starkey*, 179 B.R. 687, 692 (Bankr. N.D. Okla. 1995).

In correlation, Rule 1009 of the Federal Rules of Bankruptcy Procedure similarly provides that a debtor "may" amend a voluntary petition, list, schedule or statement "at any time" before the case is closed. Fed. R. Bankr. P. 1009. Judicial interpretation of this same quoted language in context of a debtor's asserted "absolute" right to amend exemptions is instructive. This same language has consistently been interpreted as allowing courts discretion to deny amendments to exemptions where the debtor has acted in bad faith by concealing or undervaluing assets, or where the debtor's concealment and delay in seeking amendment unfairly prejudices creditors. *See Ladd v. Ries (In re Ladd)*, 450 F.3d 751, 755 (8th Cir. 2006); *Hannigan v. White (In re Hannigan)*, 409 F.3d 480, 481-82 (1st Cir. 2005); *In re Rolland*, 317 B.R. 402, 414 (Bankr. C.D. Cal. 2004). These cases further illustrate that bankruptcy courts are loathe to grant absolute rights and privileges to debtors who intentionally conceal or undervalue assets, further supporting the First Circuit's interpretation of § 706.

The second sentence in § 706(a) provides that "any waiver of the right to convert is unenforceable." The First Circuit correctly interpreted this phrase as a consumer protection provision against contracts of adhesion, rejecting the Petitioner's argument that the language means a debtor cannot be divested of the right to convert even where the outcome of conversion is to shield the debtor from his own willful misconduct and abuse. *See Marrama*, 430 F.3d at 479.

Therefore, the two explicit protections stated in § 706(a) are limited by the language of the section itself.

While § 706(a) contains these explicit protections of the debtor's right to convert, it does *not* state that the right is absolute. If Congress intended the debtor's right to convert to be absolute, the statutory language would so provide. The First Circuit accordingly found that the plain language of § 706(a) is consistent with the bankruptcy court's presumptive authority to take such steps as it deems necessary to thwart abuse of the bankruptcy process, including denial of conversion from chapter 7 to chapter 13 in instances of bad faith conduct by the debtor. *See Marrama*, 430 F.3d at 480.

Most appellate courts reviewing this issue agree that the *language* of § 706(a) does not grant debtors an absolute right to convert. *See In re Copper*, 426 F.3d 810; *In re Matter of Martin*, 880 F.2d 857 (5th Cir. 1989) (recognizing that the language of § 706(a) seems to qualify the right to convert with an extreme circumstances exception); *In re Finney*, 992 F.2d 43 (4th Cir. 1993) (declining to rule on whether the right to convert under § 706(a) is absolute); *In re Young*, 237 F.3d 1168 (10th Cir. 2001) (declining to discuss the plain meaning of § 706(a)); *see also In re Brown*, 239 B.R. 865, 871 (Bankr. W.D. Mich. 2003); *In re Ponzini*, 277 B.R. 399, 404 (Bankr. E.D. Ark 2002) ("recent rulings on this issue reveal a large number of courts adopting what was previously referred to as the minority view"). *But see In re Miller*, 303 B.R. 471 (BAP 10th Cir. 2003) (finding right of conversion to be absolute based on the statutory language of § 706(a)).

B. The Legislative History of § 706(a) as a Whole, Supports Limiting the Right to Convert to Honest Debtors.

When the meaning of a statute is clear and unambiguous on its face, courts must not look beyond the statute's text to examine the relevant legislative history. *See In re Weinstein*, 272 F.3d 39, 43 (1st Cir. 2001) *(citing Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6, 10 (2000)). The First Circuit determined it was nevertheless appropriate to examine the legislative history in this case, in light of controversy among the various bankruptcy and appellate courts in interpreting § 706(a).

The legislative history in support of § 706(a) describes the debtor's right to convert as "absolute."[10] This language is cited and relied upon by Petitioner and NACBA in their arguments, and is cited in cases holding that a bankruptcy court lacks the discretion to deny a debtor's conversion from chapter 7 to 13. In response to these arguments, the First Circuit determined that the term "absolute" cannot be taken out of context, and that the collective language of § 706(a) and § 105 clearly indicates that conditions exist that could defeat the debtor's motion to convert. *See Marrama*, 430 F.3d at 480.

The First Circuit reasoned that while the pronounced policy of § 706(a) is that a debtor always be given an opportunity to repay his debts, implicit in this policy is that this opportunity is available only to *honest* debtors:

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[10] *See* S. Rep. No. 95-989, at 94; *see also supra* note 2.

> Nothing in the legislative history remotely negates nor undermines the overarching principle that the bankruptcy courts are duty bound to take all reasonable steps to preclude debtors from abusing or manipulating the bankruptcy process in order to undermine the essential purposes of the Bankruptcy Code.

Id.

The First Circuit reviewed the bankruptcy court's assessment of the facts for clear error, with reference to the "totality of circumstances" approach. Under this approach, a court reviews various factors to determine whether the particular circumstances are sufficiently egregious to warrant a finding of bad faith and denial of conversion to chapter 13. *See Marrama*, 430 F.3d at 482; *see also Sullivan v. Solimani (In re Sullivan)*, 326 B.R. 204 (BAP 1st Cir. 2005); *see also Cabral v. Shamban (In re Cabral)*, 285 B.R. 563 (BAP 1st Cir. 2002).

Factors utilized by some courts in examining the totality of circumstances in the chapter 7 to 13 conversion context include: (1) the debtor's accuracy in stating debts and expenses; (2) the debtor's honesty in the bankruptcy process, including whether he or she has attempted to mislead the court or has made misrepresentations; (3) whether the Bankruptcy Code is being unfairly manipulated; and (4) the debtor's motivation in seeking chapter 13 relief. *See Marrama*,

430 F.3d at 482; *In re Sullivan*, 326 B.R. at 212; *see also In re Cabral*, 285 B.R. at 573.

Reviewing the record before it, the First Circuit upheld the finding of the bankruptcy court that the Petitioner's conduct, including his failure to disclose assets and prepetition transfers of property on his schedules, and misrepresentation of the value of vacation property placed in trust shortly before the filing of the petition, constituted bad faith. Accordingly, the Court correctly affirmed that the bankruptcy court acted within its discretion in denying the debtor's motion to convert to chapter 13. *See Marrama* at 481-83.

III. THE BANKRUPTCY CODE DOES NOT AFFORD ABSOLUTE RIGHTS OR PRIVILEGES TO DEBTORS WHO ACT IN BAD FAITH AND ABUSE THE BANKRUPTCY SYSTEM.

The First Circuit correctly framed the issue in this case as whether a chapter 7 debtor has an "absolute" right to convert to chapter 13, and then held that both the terms of the statute and the policies contained in the legislative history dictate that a debtor does not. *See Marrama*, 430 F.3d at 477. Two weeks previous, the Sixth Circuit Court of Appeals similarly held that a chapter 7 debtor's motion to convert to chapter 13 could and should be denied in the absence of the debtor's good faith. *See Copper v. Copper (In re Copper)* 426 F.3d 810, 816 (6th Cir. 2005)(quoting at length and adopting the position of the Sixth Circuit

Bankruptcy Appellate Panel contained in *In re Copper*, 314 B.R. 628 (BAP 6th Cir. 2004)).

In *Copper*, the Sixth Circuit Court of Appeals based its holding on: (1) the similar logic in a court's ability to dismiss a chapter 13 case as filed in bad faith; (2) § 706(a)'s use of the word "may" instead of "shall"; (3) inconsistencies contained in the legislative history; and (4) the common sense notion that a bankruptcy court should have the authority to police the integrity of its proceedings. *See In re Copper*, 426 F.3d at 817.

The *Copper* Court found that legislative history purporting to suggest a one-time absolute right to convert cannot be implemented without looking at the policy behind that right, (as stated in the same legislative history), which is to give debtors an opportunity to repay their debts. The Sixth Circuit observed that where a debtor seeks conversion not for the opportunity to repay debts, but instead to abuse the bankruptcy system and thwart attempts to collect assets, allowing conversion "turns on its head the policy reason for providing a debtor with such a right." *See Id.* (*citing In re Copper*, 314 B.R. at 634-47).

Similarly, the First Circuit expressly acknowledged the general policy that a debtor should be given a chance to effectuate a chapter 13 plan. However, it further noted that it is "plainly implicit in this legislative observation . . . that such an opportunity is to be accorded only to *honest* debtors." *See Marrama*, 430 F.3d at 480 (emphasis in original).

Unfortunately, but in relatively few instances, a debtor's motivation in seeking conversion is not to repay creditors. Rather, it is to utilize § 706(a) manipulatively, abusively, in bad faith, or under gross inequities. Therefore, if the impetus for the policy fails to exist in a particular case, then so should the policy itself. *See In re Spencer*, 137 B.R. 506, 512 (Bankr. N.D. Okla. 1992), *citing In re Marcakis*, 254 B.R. 77, 81 (Bankr. E.D. N.Y. 2000); *see also Kuntz v. Shambam (In re Kuntz)*, 233 B.R. 580, 583 (BAP 1st Cir. 1999).

Accordingly, while the legislative history underscores the importance of giving debtors the opportunity to repay debts, this opportunity does not rise to the level of an absolute right or privilege. Rather, the circuit courts in *Copper* and *Marrama* would restrain a debtor's right to convert only where denial of conversion does not offend the policy of § 706. On the contrary, and out of necessity, in order to advance the fundamental principle that bankruptcy courts must not be used to further fraudulent purposes, courts adhering to the *Copper* and *Marrama* reasoning have barred motions under § 706 only where the motivation for conversion contravenes basic bankruptcy policy.

As such, cases where conversion has been denied include instances where debtors: (1) fail to disclose assets; (2) file inaccurate schedules and statements, falsify documents, or testify falsely in bankruptcy proceedings; (3) convert to prevent the sale of assets or to impact pending litigation; and (4) otherwise impede the administration of the case and the liquidation of assets. *See, e.g., Martin v. Cox*, 213 B.R. 571 (E.D. Ark. 1996), *aff'd*, 116 F.3d 480 (8th Cir.

1997); *In re Cabral*, B.R. at 575; *In re Brown*, 293 B.R. 865 (Bankr. W.D. Mich. 2003); *In re Carter*, 285 B.R. 61, 65 (Bankr. N.D. Ga. 2002); *In re Gallagher*, 283 B.R. 604 (Bankr. M.D. Fla. 2002); *In re Ponzini*, 277 B.R. 399 (Bankr. E.D. Ark 2002); *In re Porter*, 276 B.R. 32 (Bankr. D. Mass. 2002); *In re Johnson*, 262 B.R. 75, 79 (Bankr. E.D. Ark. 2001); *In re Thornton*, 203 B. R. 648 (Bankr. S.D. Ohio 1996).

These bad faith conversion cases in all instances revolve around a dishonest and manipulative debtor who seeks conversion to escape from the perils he himself has created. These are not cases involving honest mistakes or inadvertent omissions by debtors. Instead, the debtors' conduct in these cases present extreme circumstances of fraud or abuse, which rise to the level of bad faith. Therefore, under the *Copper* and *Marrama* rationale, conversion from chapter 7 to chapter 13 would only be denied in those rare instances where a dishonest debtor seeks to abuse and manipulate the process to further his own fraudulent purposes.

Case law in other areas where bad faith conduct by debtors is denounced by bankruptcy courts demonstrates that denial of conversion is only one of the ramifications of bad faith conduct. For example, while exemptions are liberally construed under the Bankruptcy Code,[11] and amendments to schedules are

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[11] *See Wilder v. Inter-Island Stream Nav. Co.*, 211 U.S. 239, 29 S. Ct. 53 (1908); *In re Caron*, 82 F.3d 7 (1st Cir. 1996); *In re Nguyen*, 211 F.3d 105 (4th Cir. 2000).

freely allowed,[12] a debtor who intentionally fails to file accurate schedules and statements and is found to be acting in bad faith may forfeit assets ordinary protected by the exemption provisions of the Bankruptcy Code. *See In re Rolland*, 317 B.R. 402, 413-14 (Bankr. C.D. Cal. 2004).

To illustrate, the First Circuit recently upheld the bankruptcy court's denial of the debtors' amendment to their schedules seeking to increase the value of their homestead exemption, as a sanction for intentionally concealing a 34 acre "back parcel" and undervaluing their residence (including this back parcel), on their schedules. *See Hannigan v. White (In re Hannigan)*, 409 F.3d 480, 483 (1st Cir. 2005). More remarkable, in *In re Rolland*, 317 B.R. at 414-16, the California Bankruptcy Court denied the debtors' amendment to increase their homestead exemption where the debtors intentionally undervalued their residence in their schedules, filed numerous amendments in response to the trustee's nine continued meetings of creditors where discrepancies in the debtor's schedules were belatedy revealed, and then sabotaged the chapter 7 trustee's efforts to sell the property by employing such "scorched earth" tactics as obstructing access to prospective buyers, uprooting signage, posting home defects and crime statistics, and presenting an appearance of disorder and neglect.

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[12] Rule 1009 of the Federal Rules of Bankruptcy Procedure provides that a debtor "may" amend a voluntary petition, list, schedule or statement "at any time" before the case is closed. Fed. R. Bankr. P. 1009. *See* discussion *supra* under Argument II(A), noting the same discretionary language in used both § 706(a) of the Bankruptcy Code and Bankruptcy Rule 1009.

Similarly, post-petition bad faith conduct by the debtor, such as concealment or conversion of estate assets or failure to turn over property of the estate to the chapter 7 trustee, may cause a bankruptcy court to invoke its equitable powers pursuant to § 105(a) and "surcharge" a debtor's exempt property. *See Latman v. Burdette*, 366 F.3d 774, 786 (9th Cir. 2004); *In re Koss*, 319 B.R. 319, 323 (Bankr. D. Mass. 2005); *In re Karl*, 313 B.R. 827, 831 (Bankr. W.D. Mo. 2004). Consistent in all these cases is the bankruptcy court's refusal to enable debtors to invoke the Bankruptcy Code in bad faith for the purpose of manipulating and abusing the bankruptcy system, while simultaneously enjoying its benefits and protections.

Under the totality of circumstances approach articulated in *Copper* and *Marrama*, debtors *who abide by the basic bankruptcy principle that courts must not be used to further fraudulent purposes*, and are otherwise eligible,[13] encounter no difficulty in converting to chapter 13 in order to repay their debts, as encouraged by the underlying policy of § 706(a). Indeed, this category encompasses the vast majority of debtors. Excluded are only those few unscrupulous, dishonest debtors who seek to use the bankruptcy process to thwart and defraud creditors rather than attempt to repay them to the best of their ability.

For example, in one recent case the bankruptcy court denied a chapter 7 debtor's motion to convert to chapter 13, finding that the motion was not motivated

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[13] *See* 11 U.S.C. § 706(d) (to convert under § 706(a) the debtor must be eligible for relief under chapter 13 as set forth in 11 U.S.C. § 109(e)).

by the debtor's desire to repay debts, but was merely the debtor's latest attempt to manipulate the bankruptcy process and avoid the sale of certain real property by the chapter 7 trustee. *See In re Brown*, 293 B.R. 865, 871 (Bankr. W.D. Mich. 2003). In the course of his chapter 7 case, the debtor had undervalued his property on his schedules, failed to timely pay his filing fee, repeatedly failed to appear at rescheduled meetings of creditors, refused to testify when he did appear, and denied the trustee and prospective purchasers access to the property despite court orders compelling him to do so. *See id.* at 867-68. The debtor filed a motion to convert to chapter 13 only after the trustee sought and received permission to sell the subject property.

The *Brown* Court refused to apply § 706(a) in a "restrictive and rigid manner," finding instead that a debtor's request to convert should be granted in "all but the most egregious circumstances." *See In re Brown*, 293 B.R. at 869; *see also In re Wampler*, 302 B.R. 601, 606 (Bankr. S.D. Ind. 2003) (conversion denied on objection of chapter 7 trustee following debtor's failure to turn over funds obtained from recovery of non-exempt lawsuit); *In re Porter*, 276 B.R. 32, 37-38 (Bankr. D. Mass. 2002) (conversion denied on objection of chapter 7 trustee following trustee's discovery of pre-petition transfer of assets to family members not disclosed in schedules).

In addition to sanctioning bad faith conduct by dishonest debtors, allowing bankruptcy courts limited discretion to deny a debtor's motion to convert increases overall coherence of the Bankruptcy Code. A

motion to convert a chapter 7 case to chapter 13 under § 706(a) amounts to the debtor filing anew in chapter 13. *In re Brown*, 293 B.R. at 870. It is well settled that a debtor cannot file a chapter 13 petition in bad faith. As the First Circuit points out - a bankruptcy court has "unquestioned authority" to dismiss a chapter 13 case based upon a showing of a debtor's bad faith. *Marrama* 430 F.3d at 479 (*citing, inter alia, In re Alt*, 305 F.3d 413, 418-19 (6th Cir. 2002); *see also In re Love*, 957 F.2d 1350, 1354 (7th Cir. 1992); *In re Cabral*, 285 B.R. at 575. Hence, "[i]f a chapter 13 petition may be dismissed for lack of good faith, it is logical to conclude that conversion from chapter 7 to chapter 13 may also be denied in the absence of good faith." *In re Brown*, 293 B.R. at 870 *(citing Alt. v. United States (In re Alt)*, 305 F.3d 413 (6th Cir. 2002)).

Even those courts finding an absolute right to convert under § 706(a), recognize that once the debtor has converted to chapter 13, a bankruptcy court may *sua sponte* reconvert the debtor's case to chapter 7 for lack of good faith. *See* 11 U.S.C. § 1307(c); *Croston v. Davis (In re Croston)*, 313 B.R. 447, 453 (BAP 9th Cir. 2004); *In re Cabral*, 285 B.R. at 572. These cases, while achieving the proper outcome, do so by acquiescing to the notion that even dishonest debtors who abuse the system have a right to become, albeit momentarily, debtors in possession of the assets they fraudulently misrepresent or conceal.

The requirement that a chapter 13 petition be filed in good faith is now explicit in the Bankruptcy Code, as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

("BAPCPA"). BAPCPA amended § 1325, by adding subsection (a)(7), providing that plan confirmation is dependent upon whether "the action of the debtor in filing the petition was in good faith." 11 U.S.C. § 1325(a)(7). While the debtor in the instant case is not subject to the provisions of BAPCPA, today, upon a finding of bad faith, the debtor would not be eligible for chapter 13, and therefore would not meet the express requirements for conversion in § 706(a). *See In re Hall*, 346 B.R. 420 (Bankr. W.D. Ky. 2006) (pursuant to amended Bankruptcy Code, a bankruptcy court can either dismiss case or deny confirmation of proposed plan if it finds that the debtor's petition was filed in bad faith).

In fact, both the Petitioner and NACBA acknowledge that a case in which a debtor acts in bad faith is subject to dismissal or reconversion to chapter 7 pursuant to § 1307 at the bankruptcy court's discretion. (Br. of Nat'l Ass'n of Consumer Bankr. Atty's at 18; Br. of Pet. at 23-24); *see* 11 U.S.C. § 1307. NACBA suggests that giving a bankruptcy court similar discretion to deny conversion would amount to a duplicative remedy. This is not the case, as the First Circuit Court of Appeals articulates. First, it hardly promotes efficient administration or use of judicial resources to force a court faced with patently bad faith conduct to allow a conversion, only to reconvert or dismiss that same case due to precisely the same conduct. Moreover, these two sections are not duplicative, as bad faith justifying dismissal of a converted case can occur post-conversion, as well as pre-conversion. *See Marrama*, 430 F.3d at 481; *Kowal v. Malkemus (In re Thompson)*, 965 F.2d 1136, 1145 (1st Cir. 1992).

NACBA further suggests that creditors are sufficiently protected by the "best interest of creditors' test,"[14] which precludes confirmation unless creditors receive at least as much as they would in a chapter 7 case, and also by the presence of the chapter 13 trustee. (Br. of Nat'l Ass'n of Consumer Bankr. Atty's at 18). As argued earlier, and contrary to NACBA's assertions, the chapter 13 trustee does not exercise the same powers of financial investigation and oversight as the chapter 7 trustee. Also, delaying reconversion to chapter 7 until confirmation wastes the time and resources of the court and creditors, and does not address the overarching issues of bad faith and abuse of the bankruptcy process. This abuse includes the debtor's potential inactivity intended to prompt a dismissal, thereby evading the chapter 7 trustee's pursuit of a recovery or enforcement action, and then awaiting the expiration of a statute of limitations, or taking other evasive action, before filing another bankruptcy petition.

While bankruptcy offers a fresh start to those individuals who genuinely need it, this opportunity does not include the right to ignore the duties and obligations inherent in the bankruptcy process. *United States v. Thomas*, 342 B.R. 758, 762 (S.D. Tex. 2005). Both policy and coherence of the Bankruptcy Code favor the stance that a debtor's right to convert under § 706(a), while compelling, is not absolute. As shown, both the language of § 706(a) and its legislative history substantiates this interpretation. Indeed, the most fundamental bankruptcy policy itself dictates that there

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[14] 11 U.S.C. § 1325(a)(4).

are no absolute rights or privileges afforded to those who manipulate and abuse the bankruptcy system.

CONCLUSION

The Bankruptcy Code's provision for discharging debts and providing a fresh start to debtors is not the equivalent of an absolute right. Instead, it is a privilege reserved for those honest but unfortunate debtors who provide candid and complete disclosures and cooperate within the bankruptcy system. *See In re Hansen*, 325 B.R. at 757; *see also Grogan v. Garner*, 498 U.S. 279, 287 (1991).

In situations where debtors exhibit bad faith and disregard their statutory mandate of complete and accurate disclosures and cooperation with the chapter 7 trustee in the administration of the case, bankruptcy courts are obligated to restrict privileges and protections ordinarily available to honest debtors. To comply with this duty, bankruptcy courts are empowered under § 706(a) and § 105(a) of the Bankruptcy Code to take reasonable steps to prevent such abuse and manipulation of the bankruptcy process, including the ability to deny conversion from chapter 7 to chapter 13.

Based on the foregoing, the National Association of Bankruptcy Trustees, as *Amicus Curiae* in support of Respondent, Mark G. DeGiacomo, Chapter 7 Trustee, respectfully requests that the decision of the First Circuit Court of Appeals be affirmed.

Respectfully submitted,

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